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In the Supreme Court of the United States

OCTOBER TERM, 1984

NORTHEAST BANCORP, INC., ET AL.

Petitioners

v.

THE BOARD OF GOVERNORS OF
THE FEDERAL RESERVE SYSTEM

Respondent

and

BANK OF NEW ENGLAND CORPORATION, CBT CORPORATION, HARTFORD NATIONAL CORPORATION, THE COMMONWEALTH OF MASSACHUSETTS, THE STATE OF CONNECTICUT, AND BANK OF BOSTON CORPORATION

Intervenor-Respondents

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

BRIEF FOR RESPONDENTS STATE OF CONNECTICUT AND BRIAN J. WOOLF, ITS BANKING COMMISSIONER

JOSEPH I. LIEBERMAN
Attorney General

ELLIOT F. GERSON
Deputy Attorney General

JOHN G. HAINES*
Assistant Attorney General

JAMES D. COMERFORD
Assistant Attorney General

P.O. Box 120
Hartford, Connecticut 06101

Counsel of Record

BEST AVAILABLE COPY

QUESTIONS PRESENTED

1. Whether the provisions of the Connecticut Interstate Banking Act, which allow Connecticut banks to be acquired by similar institutions in the other New England states which grant reciprocal rights to Connecticut banks, are authorized by the Douglas Amendment to the Bank Holding Company Act, 12 U.S.C. §1841 *et seq.* and thus do not violate the Commerce Clause?

2. Whether the reciprocal provisions of the Connecticut and Massachusetts Interstate Banking Acts constitute an interstate agreement increasing the power of the states in a manner which interferes with federal supremacy in violation of the Compact Clause?

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In the Supreme Court of the United States

OCTOBER TERM, 1984

No. 84-363

NORTHEAST BANCORP, INC., ET AL.

Petitioners

v.

THE BOARD OF GOVERNORS OF
THE FEDERAL RESERVE SYSTEM

Respondent

and

BANK OF NEW ENGLAND CORPORATION, CBT CORPORATION, HARTFORD NATIONAL CORPORATION, THE COMMONWEALTH OF MASSACHUSETTS, THE STATE OF CONNECTICUT, AND BANK OF BOSTON CORPORATION

Intervenor-Respondents

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

BRIEF FOR RESPONDENTS STATE OF CONNECTICUT AND BRIAN J. WOOLF, ITS BANKING COMMISSIONER

STATEMENT OF THE CASE

In June of 1983 the Connecticut General Assembly passed the Connecticut Interstate Banking Act ("the CIBA"),[1] which, *inter alia*, allows Connecticut banks to be acquired by financial institutions located in the other New England states, provided they have adopted reciprocal legislation granting the same rights to Connecticut institutions.

[1]Conn. Pub. Act 83-411, the relevant portions of which have been codified as Conn. Gen. Stat. §36-552 and §36-553, reproduced at Pet. App. A-97 to A-100.

The primary intent of the CIBA was to lift the federal prohibition against interstate acquisitions of banks in accordance with a provision of the Bank Holding Company Act ("the BHCA"), 12 U.S.C. §1841 *et seq.*, which specifically defers to state law on this issue.[2]

The BHCA, which provides for federal regulation of the creation and operation of bank holding companies, requires that any acquisition of control of a bank by a corporation or partnership must be approved by the Federal Reserve Board. Section 3(d) of the BHCA, commonly known as the "Douglas Amendment," precludes the Federal Reserve Board from approving any application by which a bank holding company proposes to acquire an interest in a bank located in another state as follows:

> [N]o application (except an application filed as a result of a transaction authorized under section 13(f) of the Federal Deposit Insurance Act) shall be approved . . . which will permit any bank holding company or any subsidiary thereof to acquire, directly or indirectly, any voting shares of, interest in, or all or substantially all of the assets of any additional bank located outside of the State in which the operations of such bank holding company's banking subsidiaries were principally conducted on July 1, 1966, . . . *unless the acquisition of such shares*

[2]It should be noted that the BHCA only applies to banks and bank holding companies. For purposes of the BHCA, the term "bank" is very narrowly defined as any institution which accepts demand deposits *and* makes commercial loans. 12 U.S.C. §1841(c). The Connecticut Act goes beyond the scope of the Douglas Amendment by including savings banks and savings and loan associations, which are subject to other regulatory schemes. This should not be an issue here, however, because all of the mergers and acquisitions challenged by the Petitioners are subject to the BHCA.

> *or assets of a State bank by an out-of-State bank holding company is specifically authorized by the statute laws of the State in which such bank is located by language to that effect and not merely by implication . . . .*

12 U.S.C. §1842(d) (emphasis added).

The Douglas Amendment thus establishes a general bar under federal law to the acquisition of a local bank by an out-of-state bank holding company but permits a state to enact specific legislation lifting this bar.

In enacting the CIBA, the Connecticut General Assembly did not read the Douglas Amendment's authorization of state action as providing a choice between no interstate banking (by leaving the federal bar in place) or unlimited interstate banking. In order to assess the benefits and detriments of interstate banking, the Connecticut General Assembly chose to authorize an experiment in interstate banking and to limit the scope of the experiment to the New England states which adopt reciprocal laws.

The other New England states, however, have taken somewhat diverse postures toward interstate banking. Maine allows virtually unlimited interstate banking.[3] New Hampshire and Vermont have taken no action, and the Douglas Amendment continues to prohibit any interstate acquisitions in those states. Rhode Island permits acquisition of its banks by institutions located in New England states with reciprocal laws until June 30, 1986, and thereafter on a nationwide reciprocal basis.[4] The Massachusetts Act, like Connecticut's, is limited to New England states with reciprocal laws.[5]

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[3]Me. Pub. Law 1983, ch. 302, §2, as amended (1984).

[4]R.I. Gen. Laws §19-30-1, 19-30-2.

[5]Mass. Gen. L. Ann. ch. 167A §2.

The present matter[6] arises out of three agreements between Connecticut and Massachusetts bank holding companies. Pursuant to the BHCA and the state acts, the Federal Reserve Board ("the Board") approved applications by Bank of New England Corp., a Massachusetts bank holding company, to acquire CBT Corp., a Connecticut bank holding company; Hartford National Corp., a Connecticut bank holding company, to acquire Arltru Bancorporation, a Massachusetts bank holding company; and Bank of Boston Corp., a Massachusetts bank holding company, to acquire Colonial Bancorp, a Connecticut bank holding company.

In the proceedings before the Board, Petitioners, Northeast Bancorp, a Connecticut bank holding company, and its subsidiary Connecticut bank, the Union Trust Company (collectively "Northeast"), and Citicorp, a New York bank holding company, opposed these transactions claiming *inter alia* that the Connecticut and Massachusetts Acts violate the Commerce and Compact Clauses of the Constitution. The Federal Reserve Board rejected these claims finding that "there is no clear and unequivocal basis for a determination that the CIBA is inconsistent with the Commerce Clause, Compact Clause or Equal Protection Clause of the United States Constitution." *Bank of New England Corporation,* 70 Fed. Res. Bull. 374, 377 (1984). (Pet. App. A-41). The same finding was made with

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[6]A related matter pending before this Court is a Petition for Writ of Certiorari in the case of *Citicorp v. Board of Governors of the Federal Reserve System,* _____ F.2d _____ (2d Cir. 1984), *petition for cert. filed,* 53 U.S.L.W. 3406 (U.S. Nov. 8, 1984) (No. 84-754). Citicorp is seeking a review of the judgments of the Second Circuit entered on October 10, 1984 and November 5, 1984, which affirmed orders of the Board of Governors approving the acquisition by Bank of Boston Corporation, a Massachusetts bank holding company, of RIHT Financial Corporation, a Rhode Island bank holding company, and the acquisition by Fleet Financial Group, Inc., a Rhode Island bank holding company, of Fleet National Bank of Boston, a Massachusetts bank, and Fleet National Bank of Connecticut, a Connecticut bank. *See* 70 Fed. Res. Bull. 737 (1984) (Bank of Boston Corporation); 70 Fed. Res. Bull. 834 (1984) (Fleet Financial Group).

regard to the Massachusetts Act. 70 Fed. Res. Bull. 353, 354 (1984).)Pet. App. A-72 to A-78).

Northeast and Citicorp appealed the Federal Reserve Board's rulings to the Second Circuit, again claiming that the Board's orders approving these transactions were unlawful because the Connecticut and Massachusetts Acts violate the Commerce and Compact Clauses of the Constitution. The Court of Appeals found both arguments without substance.

With regard to the Commerce Clause, the Court of Appeals held that the Connecticut and Massachusetts Acts were authorized by Congress in the Douglas Amendment. As to the Compact Clause, the Court held that, even if the Connecticut and Massachusetts Acts were treated as a compact, they would not violate the Compact Clause because under the test stated by this Court in *United States Steel Corp. v. Multistate Tax Commission,* 434 U.S. 452, 471 (1978), there is no "combination tending to increase the political power in the states, which may encroach upon or interfere with the just supremacy of the United States." Accordingly, the Court affirmed the orders of the Federal Reserve Board.

SUMMARY OF ARGUMENT

1. The provisions of the Connecticut Interstate Banking Act (Conn. Pub. Act 83-411, §§2, 3) which permit Connecticut banks and bank holding companies to be acquired by similar institutions in the other New England states with reciprocal laws do not violate the Commerce Clause. The CIBA is authorized by the Douglas Amendment to the Bank of Holding Company Act, 12 U.S.C. §1842(d), which prohibits the Federal Reserve Board from approving any application by a bank holding company to acquire a bank in another state unless specifically authorized by the laws of that state. The Douglas Amendment is an affirmative statement of federal policy which allows each state to determine the conditions under which out-of-state bank holding companies may enter and acquire banks within its borders.

2. Under this Court's test, the reciprocal provisions of the Connecticut and Massachusetts Interstate Banking Acts do not violate the Compact Clause because there is no interstate compact or agreement which tends to increase the power of the compacting states in a manner which interferes with federal supremacy. *United States Steel Corp. v. Multistate Tax Commission*, 434 U.S. 452 (1978); *Virginia v. Tennessee*, 148 U.S. 503 (1893). There is no overt agreement between Connecticut and Massachusetts; the state Acts provide no interstate apparatus for the regulation of bank holding companies; the state Acts do not impair the sovereign rights of non-New England states; there is no conflict between the state Acts and any regulatory scheme of the federal government in the area of bank expansion; and there can be no interference with federal supremacy because the Douglas Amendment defers to state law on the issue of interstate banking.

ARGUMENT

I

THE CONNECTICUT INTERSTATE BANKING ACT DOES NOT VIOLATE THE COMMERCE CLAUSE BECAUSE IT WAS AUTHORIZED BY CONGRESS IN THE DOUGLAS AMENDMENT TO THE BANK HOLDING COMPANY ACT.

A. STATUTORY BACKGROUND: FROM McFADDEN AND DOUGLAS TO THE CONNECTICUT ACT

The Commerce Clause issue in this case cannot be fairly understood without some discussion of the structure of American banking. That structure is, to say the least, unique both in relation to banking in other countries and in relation to other major industries in this country.

To a large extent, the present controversy turns on the construction of the Douglas Amendment. That provision, however, is merely one piece of the statutory structure of American banking and should not be viewed in isolation. The following discussion is intended to place the Douglas Amendment in context and to provide a frame of reference for the issues in this case.

1. *The Balkanization of American Banking: The McFadden Act and the Douglas Amendment*

The most striking feature of American banking is its fragmented structure. Any discussion of that structure must begin with the "dual banking system" which permits institutions to be chartered by either the states or the federal government. However, the state and federal systems are not totally separate. Over the years, the two have been tied together by a

complex network of federal regulation on the state system and various deferrals to state law in the federal system. The second point of fragmentation is the division of financial institutions along product lines (i.e., commercial banks and thrift institutions), although these lines are becoming increasingly blurred. The final point of fragmentation is geographic. Unique among American industries, banks have been prevented from expanding across state lines and, in many states, bank operations are limited to a single community. Glidden, *Legal Constraints on Bank Expansion: Can They Be Removed Without Destroying the Dual Banking System?*, 1980 U. Ill. L.F. 369 [hereinafter cited as "Glidden"]; Scott, *The Dual Banking System: A Model of Competition in Regulation*, 30 Stan. L. Rev. 1 (1977)[hereinafter cited as "Scott"]; Gorinson and Manishin, *Gain-St. Germain: A Harbinger of Change*, 40 Wash. & Lee L. Rev. 1313 (1983); *Geographic Restrictions on Commercial Banking in the United States, The Report of the President*, Dept. of the Treasury, January 1981 [hereinafter cited as "The Report of the President"].[7]

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[7]In commenting on the geographic restrictions on American banking, one expert has stated:

> [W]hat is so unusual about banking is that it, and it alone among major industries, is restricted by state lines so that each institution's operations are limited to the area of only one of the 50 separate states. Certainly a foreigner must wonder what unusual statutory circumstances allows an automobile company or a distributor of groceries or petroleum products, or, to come closer to home, a securities firm or a finance company, to open an office in any state it desires so long as it conforms to the various licensing or other provisions that might apply, but forbids a commercial bank from doing so. Many Americans, including some who are not even aware of the limitation, must wonder about the same question. If any of these other companies were ever denied the right to enter other states there would be an immediate resort to constitutional protections against barriers to inter-

The unusual statutory circumstances which led to the balkanization of American banking into fifty separate banking zones are the result of choices made by Congress to defer to the states on the issue of geographic expansion by banks.

The first expression of this federal policy is contained in the McFadden Act, adopted in 1927 and amended in 1933 (12 U.S.C. §36), which limits national banks to the same branching powers as are expressly permitted to state banks under state law.[8] The result of the McFadden Act is that banks chartered by the federal government are not allowed to operate nationally. They are locked in the same geographic compartments as their state chartered counterparts and only allowed to expand through branching in accordance with state policy. *First National Bank of Logan v. Walker Bank & Trust Co.*, 385 U.S. 252, *reh'g denied*, 385 U.S. 1032 (1966). Pursuant to the McFadden Act, the states have adopted a wide variety of branching statutes deemed suitable for each state ranging

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state commerce and the like. But this is not the case for commercial banking.

Golembe, Memorandum re: Interstate Banking, Golembe Reports Vol. 1978-6, at 4.

[8]12 U.S.C. §36(c):

> A national banking association may, with the approval of the Comptroller of the Currency, establish and operate new branches: (1) Within the limits of the city, town or village in which said association is situated, if such establishment and operation are at the time expressly authorized to State banks by the law of the State in question; and (2) at any point within the State in which said association is situated, if such establishment and operation are at the time authorized to State banks by the statute law of the State in question by language specifically granting such authority affirmatively and not merely by implication or recognition, and subject to the restrictions as to location imposed by the law of the State on State banks . . . .

from statewide branching to a complete prohibition of branching. Glidden, *supra*, at 374. The federal policy of allowing state control of bank expansion through branching has remained essentially intact since the 1933 amendment to the McFadden Act. *Id.* at 380.

The second major piece of federal legislation which confined bank expansion to the borders of the states is the Douglas Amendment to the BHCA, 12 U.S.C. §1842(d).

The bank holding company movement was primarily a response to restrictive state branching laws (as grafted onto the federal system by the McFadden Act) which limited bank expansion. Glidden, *supra*, at 380. By the time Congress addressed the bank holding company movement in any comprehensive fashion, several bank holding companies were already operating large interstate networks.[9] The response to this phenomenon, the Bank Holding Company Act of 1956, 12 U.S.C. 1841 *et seq.*, presented another forum to debate and determine the structure of American banking. Should interstate expansion be allowed and, if so, should it be subject to federal control, or state dominance as embodied in the McFadden Act?[10]

The House Committee on Banking and Currency, which opposed bank holding companies as a threat to local unit banks[11] reported out a bill which would have prohibited interstate acquisitions entirely and tied bank holding company expansion to the McFadden scheme of branch banking.[12]

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[9]*See* H.R. Rep. No. 609, 84th Cong., 1st Sess. 3-4 (1955).

[10]*See* Glidden, *supra* at 371-73 (citing Scott, *supra*).

[11]*See* H.R. Rep. No. 609, 84th Cong., 1st Sess. 2, 5 (1955); J. App. A-5 to A-7.

[12]H.R. No. 609, 84th Cong., 1st Sess. 3, 15 (1955).

The Senate disagreed with this position. Its bill did not tie bank holding company expansion to the McFadden Act framework for branch banking, and it would have permitted interstate acquisitions.[13]

In presenting the Senate bill, however, the floor manager, Senator Robertson, emphasized that Section 7 of the proposed legislation would not preempt the states from imposing greater restrictions on bank holding companies and that this adequately protected the states' interests. In making his statement, Senator Robertson quoted with approval a Georgia law which prohibited bank holding companies from owning over 15 percent of the voting stock of two or more banks in the state. 102 Cong. Rec. 6752-53 (1956). Senator Robertson thus envisioned that the states could impose conditions on the expansion of bank holding companies. It was also clear that the Senate contemplated that a state could prohibit entry by out-of-state bank holding companies. *Id.* at 6855.[14]

Predictably, the outcome of the debate over interstate acquisitions was compromise. Between the House bill and its absolute prohibition on interstate acquisitions and the Senate bill which would permit such acquisitions subject to state power to limit or prohibit entry came Senator Douglas and his amendment.

The terms of the Douglas Amendment, which were accepted by both houses of Congress, are quite clear and, in spite of subsequent events, have not been materially altered. The Federal Reserve may not allow a bank holding company to acquire an interest in a bank

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[13]S. Rep. No. 1095, 84th Cong., 1st Sess. 10-11 (1955).

[14]Section 7 of the BHCA, 12 U.S.C. §1846, is a "savings clause," intended to preserve existing state regulations of bank holding companies even if more restrictive than federal law. *Lewis v. BT Investment Managers, Inc.*, 447 U.S. 27, 48-49 (1979).

> located outside the state in which the operations of such bank holding company's subsidiaries were principally conducted on July 1, 1966 . . . *unless [such acquisition] is specifically authorized by the statute laws of the State in which such bank is located, by language to that effect and not merely by implication.*

12 U.S.C. §1842(d) (emphasis added).

Thus, unlike the original Senate bill which allowed interstate acquisitions subject to state power to block them pursuant to Section 7 of the Act, the Douglas Amendment placed a general bar to such acquisitions but allowed the states to lift it.

In urging the adoption of his amendment, Senator Douglas stated:

> [O]ur amendment will permit out of state holding companies to acquire banks in other states only to the degree that state law expressly permits them . . . .

102 Cong. Rec. 6858 (1955).

In remarking on his amendment, Senator Douglas also stated:

> [I]t is a logical continuation of the principles of the McFadden Act, which tried to prevent the Federal power from being used to permit national banks to expand across State lines in a way contrary to State policy and, of course, under the McFadden Act, even to expand within a State.

> Anyone who favors States rights, it seems to me should support my amendment. I am not urging it on that ground, however. I believe in a somewhat unified banking system. However, so far as the bank holding companies are concerned, I want to check their expansion. This seems to me to be about the best way of doing so.
>
> My good friend the Senator from Virginia [Mr. Robertson] yesterday, in his speech presenting the bill, criticized my amendment on the ground that, by making further interstate expansion more difficult, it would freeze the present situation and would aid monopoly.
>
> In the first place, it does not freeze the situation, as the analysis of the powers left to the Board makes clear. It is still possible to have an expansion of a bank holding company within its home State, if it musters the approval of the Federal Reserve Board. Moreover, if State law permits, and if approved by the Board, interstate acquisitions are possible. Therefore the amendment does not freeze the situation.

Id. at 6860.

It is therefore clear that Senator Douglas contemplated that a state might lift the federal bar on interstate acquisitions and that the purpose of the Amendment was to support *state prerogatives* along the lines expressed in the McFadden Act. Thus, it does not seem reasonable to conclude that Senator Douglas or Congress intended to limit the powers of the states by confining them to the choice of no interstate banking or unlimited entry by out-of-state bank holding companies. This

view is fully supported by the history of the bill to which the Amendment was offered. Senator Robertson clearly stated that the original bill allowed the states to place conditions on or prohibit entirely acquisitions by out-of-state bank holding companies. Further, it does not seem reasonable to conclude that the Douglas Amendment which "favors states rights" should be read as granting the states no greater powers than are contained in Section 7 of the BHCA.

Just as the McFadden Act produced a variety of branching laws, the Douglas Amendment has spawned a wide range of interstate banking laws. As noted in the staff analysis attached to the Board's order allowing the BNE/CBT merger, a number of these statutes discriminate against out-of-state bank holding companies and "result in some burdens on interstate commerce." 70 Fed. Res. Bull. at 386 (1984), Pet. App. A-71.[15] In approving applications under these statutes,

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[15] Delaware (Del. Cod. Ann., Title 5, §803), Maryland (Md. Fin. Inst. Code Ann. §5-901), Virginia (Va. Code §6.1-390 to 6.1-397) and Nebraska (Neb. Rev. Stat. §§8-905, 8-906 (Supp. 1983)) have permitted out-of-state bank holding companies to acquire local banks under certain conditions, including limitations on activities, number of offices and home office location, which are not imposed on in-state bank holding companies. One of the major purposes of such legislation is to gain employment for local residents and tax revenues for the state without seriously affecting competing local banking businesses; the statutes accomplish this by permitting out-of-state bank holding companies to export their credit card operations to states with less restrictive usury laws. Similarly, South Dakota (S.D. Codified Laws Ann. §§51-16-40 to 51-16-44, Supp. 1984) has recently permitted the entry of out-of-state bank holding companies on a limited basis to acquire a state bank with a broad range of insurance powers.

70 Fed. Res. Bull. at 386, Pet. App. A-70.

We would add that these statutes not only discriminate against interstate commerce but also discriminate against other states. The activities of

both the Board and the various states appear to have interpreted the Douglas Amendment as allowing the states to discriminate against out-of-state bank holding companies which desire to acquire or establish *a bank* within the state. [16]

Congress has the power, as it always had, to create a single order out of this diversity. Indeed, under the International Banking Act of 1978, 12 U.S.C. §611 *et seq.*, Congress required the President to report on the applicability of the McFadden Act to today's financial environment. The result was the Report of the President—Geographic Restrictions on Commercial Banking in the United States (1981).

Although the language mandating the Report refers only to the McFadden Act, President Carter broadened the study to include the Douglas Amendment. The Report discusses the history of these provisions and the nature of the existing market. In this regard, it notes that even with the McFadden Act and the Douglas Amendment, substantial interstate activity already exists, particularly on the wholesale side (i.e., large corporations and wealthy individuals frequently effect transactions with banks across state lines) and in the nationwide activities of money funds, finance companies, and non-bank subsidiaries of bank holding companies. *See also Lewis v. BT Investment Managers Inc.*, 447 U.S. 27 (1979).

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banks authorized by these statutes are intended only for export to other states. In this regard the Delaware statute is typical. It provides that a bank owned by an out-of-state bank holding company may only be "operated in a manner and at a location that is not likely to attract customers from the general public *in this state* to the substantial detriment of banking institutions located in this state . . . ." Del. Code Ann. Title 5 §803(5). (Emphasis added).

[16]The considerations are quite different where an out-of-state bank holding company proposes to acquire or establish an allowable *nonbanking* subsidiary in a state. *Lewis v. BT Investment Managers, Inc.*, 447 U.S. 27 (1979).

The Report concluded with, *inter alia*, the following recommendations:

> 1. *The Administration has concluded that the McFadden Act, as amended, and Section 3(d) of the Bank Holding Company Act are increasingly ineffective, inequitable, inefficient, and anachronistic, and that the existing de facto system of interstate banking should be ratified and further liberalized through a phased relaxation of current geographic restraints. Since government shaped the financial world that presently exists, government is obliged to create conditions which will permit an orderly evolution to a new financial environment. Liberalization of geographic limitations should be accomplished in stages to avoid shortrun instability and should be designed to foster a competitive and relatively unconcentrated system of financial intermediaries.*

The Report of the President, *supra*, at 17 (emphasis in original).

After discussing the relative merits of various approaches to the problem, the Report concluded:

> In view of these considerations, the Administration recommends that over the short term the Congress enact a phased liberalization of the Douglas Amendment. To accommodate the concerns of banks which have relied upon the existing framework, this deregulation might be accomplished in stages. For example, Congress could consider initially restricting interstate acquisitions by imposing limits on the markets

> that might be entered—*e.g., interstate acquisitions might be limited to a regional basis.* Alternatively, or in addition, Congress might impose limits on the banks to be acquired—*e.g.*, a bank eligible for acquisition by an out-of-state BHC could not hold more than a specified percentage of local market share.

The Report of the President, *supra*, at 17-18 (emphasis added).

While Congress failed to act on this report, its conclusions found a more receptive audience in Connecticut, where they could be implemented by accepting Congress' longstanding invitation in the Douglas Amendment.

2. *The Connecticut Act*

In 1979, the Connecticut General Assembly appointed a special six member commission ("the Hebb Commission") to study and report on the desirability of legislation to limit the extent to which bank holding companies (both local and out of state) may maintain an office or conduct business in Connecticut through a subsidiary. "In addition," the General Assembly stated, "the Commission shall consider such other factors as are pertinent . . . including . . . policies with respect to the interstate conduct of banking business." Conn. Pub. Act 79-563, §1, Conn. Gen. Stat. §36-5b. In the same Public Act the General Assembly placed a one year moratorium (subsequently extended to July 1, 1983) on the extension of non-banking activities of bank holding companies in the state while the Hebb Commission conducted its study (*see* Conn. Pub. Act 79-563 §2, 80-126 §2, 82-95 §1 and 82-97 §2). Meanwhile, the Hebb Commission's mandate was extended (Conn. Pub. Act 80-126 §1) and then expanded to include *inter alia* "interstate banking's relationship with and impact on

intra state banking" as well as mergers and consolidations of financial institutions. Conn. Pub. Act 82-97 (amending Conn. Gen. Stat. §36-5b).

In accordance with the General Assembly's directive, the Hebb Commission issued its findings and recommendations on January 5, 1983.[17] In its findings the Report sketched the background against which its recommendations were made, including federal deregulation and the emergence in the financial services industry of such organizations as Sears, Merrill Lynch, Shearson/American Express and others. The Commission then stated that it believed "that the interest of both consumers and businesses in Connecticut would be well served by increasing the number of competitors and the vigor of banking competition in the state." Ct. App. J.A. 1239. But, the Commission observed: "To allow the control of credit that is essential for the health of our state economy to pass to hands that are not immediately responsive to the interests of Connecticut citizens and business would not, we believe, serve our state well. Similarly, to expose our small banks to the rigors of unlimited competition from large out-of-state banking organizations . . . would not be wise." Ct. App. J.A. 1240-41.

In balancing these conflicting considerations, the Commission recommended an "experiment"[18] in interstate banking. The Commission stated that by an experiment,

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[17]Report to the General Assembly of the State of Connecticut of the Findings and Recommendations of the Commission to Study Legislation to Limit the Conduct of Business in Connecticut by Subsidiaries of Bank Holding Companies and the Impact of the Non-Depository Institutions on Traditional Banking Activities.
Court of Appeals (Ct. App.) J.A. Vol. IV at 1230-44.

[18]*See New State Ice Co. v. Liebman*, 285 U.S. 262, 311 (1932) (Brandeis, J., dissenting): "To stay experimentation in things social and economic is a grave responsibility. Denial of the right to experiment may be fraught with serious consequences to the Nation. It is one of the happy incidents of the federal system that a single courageous State may, if its citizens choose serve as a laboratory; and try novel social and economic experiments without risk to the rest of the country."

> we mean a first step toward interstate banking that would allow limited entry by out-of-state banking organizations and would afford the legislature an opportunity to make its own calculus of the benefits and detriments that might result from a broader program of interstate banking.

Ct. App. J.A. 1241.

In defining the limits of this experiment, the Commission continued to use a geographic framework like the Douglas Amendment but expanded its scope to include all of the New England states. In making this recommendation, the Commission stated:

> We believe that there is a natural economic and cultural community of interest among the New England states that would make such an experiment in regional banking a reasonable first step toward interstate banking. We further believe that the legislature would be justified in excluding New York from this first phase on the ground that New York is the home state of a number of the nation's very largest banking institutions and that it is necessary to assess the impact of out-of-state entry upon Connecticut banks in a more limited experiment in interstate banking before exposing our banking system to the full rigor of competition from these giant institutions.

Ct. App. J.A. 1242.

The terms of this experiment, which are the subject of Petitioners' challenge, were hotly debated but were ultimately passed by a wide margin in both houses of the Connecticut General Assembly.

B. THE DOUGLAS AMENDMENT IS AN AFFIRMATIVE STATEMENT OF FEDERAL POLICY WHICH ALLOWS THE STATES TO DETERMINE THE CONDITIONS UNDER WHICH OUT-OF-STATE BANK HOLDING COMPANIES MAY ENTER AND ACQUIRE BANKS IN EACH STATE

It is axiomatic that the Commerce Clause vests in Congress plenary powers to regulate commerce among the states. *Western & Southern Life Insurance Co. v. State Board of Equalization*, 451 U.S. 648, 652 (1981); *Lewis v. BT Investment Managers Inc.*, 447 U.S. 27, 35 (1979); *Prudential Insurance Co. v. Benjamin*, 328 U.S. 408, 423 (1945); *Gibbons v. Ogden*, 22 U.S. (9 Wheat) 1 (1824). It is also axiomatic that in the exercise of that power Congress has the authority to impose restrictions on interstate commerce. *Prudential Insurance Co. v. Benjamin*, 328 U.S. at 408; *United States v. Darby*, 312 U.S. 100 (1941); *Champion v. Ames*, 188 U.S. 321 (1903). Indeed, as the Court stated in *Prudential Insurance Co. v. Benjamin*, 328 U.S. at 434:

> The power of Congress over commerce . . . is not restricted, except as the Constitution expressly provides, by any limitation which forbids it to discriminate against interstate commerce and in favor of local trade.

The geographic restrictions imposed by the McFadden Act and the Douglas Amendment are examples of the exercise of that power.

It is equally well established that Congress may exercise its plenary power over commerce "indirectly by conferring upon the states an ability to restrict the flow of interstate commerce that they would not otherwise enjoy." *Lewis v. BT Investment Managers Inc.*, 447 U.S. at 44. Again, the Douglas

Amendment is an example of the exercise of this power. While it generally prohibited interstate acquisitions, it left to each state the decision whether and to what extent to allow out-of-state bank holding companies to acquire banks within its borders.

We are thus not dealing with a situation where Congress has been silent, and the dormant Commerce Clause with its implied limitation on state power is not an issue.[19] Congress affirmatively indicated its approval of state action in the Douglas Amendment, and as this Court reiterated only recently:

> If Congress ordains that the states may freely regulate an aspect of interstate commerce, any action taken by a state within the scope of the congressional authorization is rendered invulnerable to Commerce Clause challenge.

Western & Southern Life Insurance Co. v. State Board of Equalization, 451 U.S. at 652-53.

In this regard the seminal case of *Prudential Insurance Company v. Benjamin, supra,* is particularly relevant. In that case the plaintiff claimed that a tax imposed on the operations of foreign insurance companies in South Carolina, where no similar tax was required of South Carolina corporations, discriminated against interstate commerce and in favor of local business. The case was brought in the wake of the Court's decision in *United States v. Southeastern Underwriters,* 322 U.S. 533 (1944), holding that insurance was commerce subject to federal regulation. South Carolina relied on the McCarran

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[19]Indeed, the Hebb Commission Report appears to base its recommendations entirely on the proposition that Congress had authorized such state action in the Douglas Amendment. *See* Ct. App. J.A. 1238.

Act, in which Congress had responded to the *Southeastern Underwriters* decision by providing:

> [T]he Congress hereby declares that the continued regulation and taxation by the several States of the business of insurance is in the public interest, and that silence on the part of the Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several states.
>
> Sec. 2. (a) The business of insurance, and every person engaged therein, shall be subject to the laws of the several states which relate to the regulation or taxation of such business.
>
> (b) No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance . . . . 59 Stat. 33, 34; 15 U.S.C. §1011-1015.

(As cited in *Prudential Insurance Co. v. Benjamin*, 328 U.S. at 429).

In opposing South Carolina's tax, Prudential claimed that by passing the McCarran Act, "Congress neither intended to, nor could, validate such taxes." *Id.* at 419. The Supreme Court disagreed both as to the basic power of Congress "to give support to the existing and future state systems for regulating and taxing the business of insurance," *id.* at 429, and as to the intention of Congress to do so. On the basis of the McCarran Act, the Court upheld the tax.

The logic of *Prudential v. Benjamin* applies here. Congress' deferral to state law on the face of the Douglas Amendment is unequivocal. Congress clearly intended to sanction "future state systems" of regulation such as the Connecticut Act. Any decision to the contrary would render the words a nullity. It is also clear from the history of the Douglas Amendment that Congress intended to leave to the individual states the determination, on the basis of local needs, whether, and on what conditions, out-of-state bank holding companies should be allowed to enter. The root purpose of the Douglas Amendment was the protection of the local bank and local supplies of credit to serve the local economy. It was left to the states to determine how this could best be accomplished.

This view is fully supported by the long history of federal deference to state law governing expansion by banks and every case which has considered the scope of the states' authority under the Douglas Amendment.

In *Iowa Independent Bankers v. Board of Governors of the Federal Reserve System*, 511 F.2d 1288 (D.C. Cir.), *cert. denied*, 423 U.S. 875 (1975), the plaintiff, an association of Iowa bankers, appealed from a decision of the Federal Reserve Board approving the acquisition of two Iowa banks by a Minnesota bank holding company under a state law which permitted the acquisition of Iowa banks by any out-of-state bank holding company that already owned at least two banks in the state. The Iowa Act was plainly designed to serve Northwest Bancorporation, the only out-of-state bank holding company that could qualify.

The Association's appeal was based, *inter alia*, on the claim that the Iowa statute was invalid because it conflicted with the intent of Congress expressed in the Douglas Amendment.

Like the petitioners here, the Association claimed that

> implicit in the Douglas Amendment is a prohibition against discrimination between out-of-state bank holding companies. In other words, . . . the states can only decide whether to extend the right to acquire in-state banks to all out-of-state bank holding companies or to prohibit such acquisitions entirely.

511 F.2d at 1296.

Before reaching this issue, the Court had already decided that, based on the local situation, there was a rational basis for the action of the Iowa legislature. Then, after reviewing the Douglas Amendment and its history, the D.C. Circuit rejected the plaintiff's claim that the Douglas Amendment was intended to impose limitations on the power of the states. On the contrary, the Court held that

> the intent of the Douglas Amendment was to assure that the states had sufficient power to control the expansion of bank holding companies across state lines so that such expansion would not contravene state policy. Petitioner's suggested interpretation of [the Douglas Amendment] would rob the states of this power.

Id. at 1297.

The clear import of the *Iowa Bankers* case is that a state may partially lift the bar of the Douglas Amendment and impose conditions and limitations on the entry of out-of-state bank holding companies to serve local needs. The D.C. Circuit recently reaffirmed this view in *Conference of State Bank Supervisors v. Conover*, 715 F.2d 604 (D.C. Cir. 1983), *cert. denied*, _____ U.S. _____, 104 S.Ct. 1708 (1984). The Court

below also appears to have had no difficulty in reaching the same conclusion.

The legislative history of the Connecticut Act shows that its purpose was to strike a balance between the protection of local supplies of credit and the anti-competitive effects of the geographic restrictions imposed by the Douglas Amendment, in light of the realities of today's economy. In striking this balance, the Hebb Commission recommended a regional approach to interstate banking as a reasonable first step, and this proposal was ultimately incorporated in the CIBA. While the CIBA may well be said not to accord with the spirit of the dormant Commerce Clause, that "our economic unit is the Nation," *H. P. Hood & Sons v. DuMond*, 336 U.S. 525, 537 (1945), Congress clearly has the ability to discriminate in favor of local trade and just as clearly did so in the Douglas Amendment.

The Petitioners claim, however, that Congress did not authorize the states to lift the bar of the Douglas Amendment in any way that would discriminate against out-of-state institutions or unduly burden interstate commerce in bank mergers and acquisitions. We are told that not only must such authorization be "expressly" stated in federal law, *New England Power Company v. New Hampshire*, 455 U.S. 331, 340-41 (1982), *Sporhase v. Nebraska*, 458 U.S. 941 (1982); *South-Central Timber Development Inc. v. Wunicki*, ____ U.S. ____, 104 S.Ct. 2237 (1984), but also that such expression must precisely describe the particular state action Congress intends to authorize.

Our response may be brief. First, the Petitioners' argument that the geographic criteria used in the CIBA could not have been authorized by Congress because the debate on the Douglas Amendment does not mention any particular method of lifting its state line geographic restrictions is totally without

merit. As this Court's decisions make clear, Congress may sanction "future state systems" of regulation, *Prudential Insurance Co. v. Benjamin*, 328 U.S. at 429, and any such future state system which is "within the *scope* of the Congressional authorization" is rendered invulnerable to Commerce Clause challenge. *Western & Southern Life Insurance Co. v. State Board of Equalization*, 451 U.S. at 652-53 (emphasis added).[20]

Second, the Douglas Amendment is distinctly different from the situations presented in *South-Central Timber Development Inc. v. Wunicki, supra, Sporhase v. Nebraska, supra,* and *New England Power Company v. New Hampshire, supra,* where the Court could not find any express authorization for state action. Indeed, because of the nature of the industry, the history of state dominance in the area of bank expansion and the broad language of the Act, the Douglas Amendment more nearly resembles the McCarran Act, *supra.*

The Petitioners' attempt to read the negative implications of the Commerce Clause (and its implied hostility to state economic protectionism) into the Douglas Amendment is similarly unavailing. The Douglas Amendment—a federal Act—totally blocks the interstate acquisition of banks by bank holding companies. If there is one proposition on which no one can disagree, it is that the Douglas Amendment was not passed to facilitate the free flow of commerce. There is also no indication in the Douglas Amendment (or the McFadden Act) that uniformity of regulation among the states is required in the national interest. Indeed, the intent of Congress appears to have been quite the opposite. The result is our balkanized banking system.

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[20]Although the issue arose in a different context, in *White v. Massachusetts Council of Construction Employers*, _____ U.S. _____, 103 S.Ct. 1042, 1047 (1983), far from requiring specific *Congressional* authorization, the Court relied on federal *regulations* to exempt the challenged action from the restrictions of the Commerce Clause.

In short, *Congress* restricted the flow of interstate commerce. But it gave the states the power to remove the obstruction—to further state policies—not because of any national interest in the free flow of commerce. In light of the severe geographic restrictions on bank holding company expansion imposed by Congress, it is difficult to see how it can be claimed at all that the Connecticut Act "burdens" interstate commerce. Absent action by a state, there is no such commerce. Indeed, as the Court below observed:

> [I]n permitting interstate acquisitions (albeit limited to New England) the Massachusetts and Connecticut statutes would appear to promote interstate commerce rather than restrict it.

740 F.2d at 208.

The Commerce Clause, and more particularly the dormant Commerce Clause, "protects the interstate market, not particular interstate firms, from prohibitive or burdensome regulations." *Exxon Corp. v. Governor of Maryland*, 437 U.S. 117, 127 (1978). While the Connecticut Act may not benefit the petitioners, it cannot seriously be claimed that the CIBA harms an interstate market which cannot even exist absent state action.

Reliance on *Lewis v. BT Investment Managers Inc., supra,* is also misplaced. The Court was not there dealing with the acquisition of a bank by an out-of-state bank holding company subject to Section 3(d) of the BHCA (the Douglas Amendment). That case dealt with a non-bank, investment advisor subsidiary of a bank holding company subject to Section 4 of the BHCA (12 U.S.C. §1843), which imposes no geographic restraints. *See* Glidden, *supra,* at 382. Indeed, the Court held

that the Douglas Amendment did not even apply. Yet we are directed to a few lines of dicta where the Court observed:

> The only authority granted to the states [in the Douglas Amendment] is the authority to create exceptions to [the Douglas Amendment] general prohibition . . . .

447 U.S. at 47. But this is precisely what Connecticut had done here—create an exception to the general prohibition.

In sum, the provisions of the Connecticut Act which allow entry by out-of-state bank holding companies but which condition such entry on the geographic origin of the acquiring institution and the grant of reciprocal rights to Connecticut institutions are authorized by the Douglas Amendment. Those provisions do not intrude on the national power to regulate commerce among the states granted to Congress in the Commerce Clause, or any national interest in the free flow of commerce.

II

THE CONNECTICUT ACT IS NOT AN INTERSTATE AGREEMENT WHICH VIOLATES THE COMPACT CLAUSE

The Compact Clause, which provides that "[n]o state shall, without the Consent of Congress . . . enter into any Agreement or Compact with another State . . .," is violated only where there is an interstate compact or agreement, which tends to increase the power of the compacting states in a manner which interferes with federal supremacy. *United States Steel Corp. v. Multistate Tax Commission,* 424 U.S. 452 (1978); *Virginia v. Tennessee,* 148 U.S. 503 (1893).

In addressing this issue, we note first that the passage of reciprocal legislation in Connecticut and Massachusetts did not occur pursuant to any explicit or tacit legislative or executive agreement. Rather, it constituted the independent act of each state. The enactment of such reciprocal legislation does not automatically create a "compact." *See New York v. O'Neill*, 359 U.S. 1, 9 (1959); *Bode v. Barrett*, 344 U.S. 583, 586 (1953).

While the Petitioners make much of the fact that a Massachusetts legislator, Senator Brennan, convoked a meeting of bankers, regulators, and legislators from the New England states to consider regional interstate banking in New England (Citicorp Brief at 5), it does not appear from the record that this meeting was officially sponsored by either Connecticut or Massachusetts. Further, the fact that Senator Brennan testified before a committee of the Connecticut General Assembly is not evidence of an interstate compact. Moreover, as indicated by the legislative history of the CIBA and the 1981 Report of the President discussed *supra* page 16), the concept of regional interstate banking has existed for some time and did not stem from any agreement between Connecticut and Massachusetts as implied by the Petitioners. Finally, the fact that Connecticut, like New York before it (*see* N. Y. Banking Law §142-b (McKinney Supp. 1983)), adopted a reciprocal interstate banking law is not proof of an interstate agreement. As shown from the legislative history of the Connecticut Act, its purpose was to benefit Connecticut by increasing competition—but mindful of the possible adverse consequences to small banks, unlimited interstate banking would have to await an evaluation of the experiment authorized by the Connecticut General Assembly. The fact that this experiment incidently confers a benefit on banks in such other New England states which adopt reciprocal laws—and does not confer a similar benefit on banks in other states—is not evidence of an agreement between states.

Second, even if a compact could be said to exist, it fails the second prong of the test in *United States Steel.* There is no increase in the power of the compacting states in any manner which interferes with federal supremacy.

No independent commission or other administrative body is authorized by the Connecticut Act. The Act does not create any interstate apparatus for the administration of bank holding companies, nor does it commit any state to approve any particular acquisition.[21] In this regard it should be noted that the Connecticut Act merely lifts the bar of the Douglas Amendment. Other state laws set forth the criteria under which individual mergers or acquisitions will be considered.[22] Each state separately administers its own law, retaining discretion to apply its own independent standards. The Connecticut and Massachusetts Acts simply reflect the exercise of each state's sovereign power. Neither separately nor as a group have the New England states created power in excess of that which flows from their individual enactments. Thus, like the multistate arrangement in *United States Steel,* the Connecticut and Massachusetts Acts are neither intended to, nor have the purpose of, enhancing the political power of the "compacting" states.

Nevertheless, Petitioners, purporting to rely on *United States Steel,* contend that in some unspecified manner the Connecticut Act impairs the sovereign rights of non-New England states so as to disrupt the federal system. It should be noted, however, that absent the lifting of the bar of the

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[21]In *United States Steel* some 21 states adopted legislation which established an independent commission composed of tax administrators for the purpose of creating an interstate apparatus for the administration of the taxation of multistate businesses. Thus, the Connecticut Act would be far less intrusive of federal supremacy than the arrangement upheld in *United States Steel,* 434 U.S. at 472-73.

[22]*See, e.g.,* Conn. Gen. Stat. §§36-30, 36-92, 36-93, 36-140.

Douglas Amendment, Petitioners would still be prohibited from expanding across state lines. Thus, it cannot be said that the reciprocal Acts "redowned" to the harm of, or impair the interests of, other states. Indeed, Petitioners have failed to specify exactly and concretely how the Connecticut Act harms other states. Their argument is, in effect, an equal protection claim that all states must be treated equally. However, the Compact Clause contains no requirement that all states be accorded equal treatment. Further, the risk of any potential harmful effects are "independent of the Compact," since the individual states could have imposed identical effects without entering into an agreement. *United States Steel*, 434 U.S. at 473, 478. Secondly, while Petitioners claim that " 'Congress is the proper body to evaluate the extent of the harm being imposed on non-compact states, and to impose ameliorative restrictions as might be necessary,' "[23] Congress has not found it necessary to impose such restrictions.

Finally, the Connecticut Act does not interfere with federal supremacy. As a matter of federal policy, Congress has unequivocally deferred to the states—in the Douglas Amendment and in other federal acts—on the issue of bank expansion within the borders of the states. Further, although Congress allowed the states to lift the limitation on interstate acquisitions of banks by bank holding companies, the Federal Reserve Board maintains full power and authority to pass upon all such acquisitions permitted by state laws. State laws cannot operate so as to permit holding companies to make acquisitions in a manner that would be inconsistent with federal standards. Thus, federal supremacy relating to the expansion of bank holding companies remains fully protected and the exercise by the states of the power given to them would not constitute an unwarranted intrusion on that supre-

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[23]Citicorp Brief at 43 (quoting *United States Steel*, 434 U.S. at 496 (White, J., dissenting)).

macy. The Connecticut and Massachusetts Acts do not require Congressional approval under the Compact Clause because "they neither project a new presence onto the federal system nor alter a state's basic sphere of authority." L. Tribe, *Intergovernmental Immunities in Litigation, Taxation and Regulation: Separation of Power Issues in Controversies About Federalism*, 89 Harv. L. Rev. 682, 712 (1976).[24]

Nevertheless, Petitioners claim a potential for direct conflict between the CIBA and the failing bank provision, 12 U.S.C. §1823(f), added by the Garn-St. Germain Depository Institutions Act of 1982.[25] Such a claim ignores the express terms of that federal statute. Specifically, 12 U.S.C. §1823(f) provides that in certain circumstances the FDIC may permit the acquisition of a failing local bank by an out-of-state bank holding company. Before approving such transaction, however, the FDIC must consult with the local bank supervisor in the state of the failing bank and give the supervisor 48 hours to object to the use of the failing bank provision. If the state supervisor objects, the FDIC may use the provision only upon

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[24]Petitioners appear to confuse potential impact on "federal interests" with threats to "federal supremacy." *See* Citicorp Brief at 45; Northeast Brief at 37 n.32. *See also* Brief for the State of New York, as *Amicus Curiae*, at 11. That there is a federal interest no one denies. However,

> "[a]bsent a threat of encroachment or interference through enhanced state power, the existence of a federal interest is irrelevant. Indeed, every state cooperative action touching interstate or foreign commerce implicates some federal interest. Were that the test under the Compact Clause, virtually all interstate agreements and reciprocal legislation would require congressional approval."

United States Steel, 434 U.S. at 479, n.33.

[25]*See* Citicorp Brief at 46; brief for the State of New York, as *Amicus Curiae*, at 11.

the unanimous vote of its Board of Directors. 12 U.S.C. §1823(f)(3)(c). Thus, the failing bank provision ameliorates any prospect for conflict between federal and state laws.[26] If such a hypothetical conflict did occur, however, the Supremacy Clause would make the federal determination controlling. *Fidelity Federal Savings and Loan Association v. de la Cuesta*, 458 U.S. 141 (1982). Thus, it cannot be said the Connecticut Act interferes, or is in any way inconsistent, with any regulatory scheme of the federal government in the area of bank expansion.

In short, Petitioners' Compact Clause argument is, in effect, nothing more than a rehash of their Commerce Clause claim. In this regard, the *United States Steel* Court, in rejecting the argument that by creating economic pressure on non-member states to join the multistate arrangement, the compact was an affront to federal sovereignty of sister states, held that even though such pressure was created,

> [u]nless that pressure transgresses the bounds of the Commerce Clause or the Privileges and Immunities Clause of Art. IV, §2, it is not clear how our federal structure is implicated.

434 U.S. at 478.

As previously discussed, *see* section I *supra*, the Connecticut Act does not transgress the bounds of the Commerce Clause and therefore does not violate the Compact Clause.

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[26]If the Garn-St. Germain Depository Institutions Act has any relevance to this case, it is to once again demonstrate the extreme deference of federal authorities to state control of bank expansion. Even where a bank is failing, Congress required the FDIC, the federal insurer, to look first to in-state institutions as a merger partner and required consultation with the state supervisor. *See* 12 U.S.C. §1823(f).

In sum, because the Connecticut Act is not part of an interstate compact and, further, because it in no way enhances state political powers or encroaches on federal supremacy, the Act does not violate the Compact Clause.

CONCLUSION

For the reasons set forth above, the Respondent, State of Connecticut, respectfully asserts that the decision of the Court of Appeals should be upheld.

Respectfully submitted,

STATE OF CONNECTICUT
AND BRIAN J. WOOLF,
ITS BANKING COMMISSIONER

JOSEPH I. LIEBERMAN
Attorney General

ELLIOT F. GERSON
Deputy Attorney General

JOHN G. HAINES*
Assistant Attorney General

JANE D. COMERFORD
Assistant Attorney General

P.O. Box 120
Hartford, Connecticut 06101
Tel. (203) 566-4899

**Counsel of record*